ISSUE DATE: December 11, 1998

DOCKET NO. G-002/GR-97-1606

ORDER AFTER RECONSIDERATION

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey	Chair
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner
Gregory Scott	Commissioner

In the Matter of the Application of Northern States Power Company's Gas Utility to Change its Schedule of Gas Rates for Retail Customers Within the State of Minnesota, Docket No.

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PROCEDURAL HISTORY

On September 30, 1998 the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER in this matter.

On October 19, 1998, Northern States Power Company - Gas Utility (NSP) filed a Petition for Rehearing and Reconsideration of the Commission's September 30, 1998 Order. NSP requested rehearing and reconsideration of three issues:

- Should the Conservation Cost Recovery Charge (CCRC) be excluded from calculation of minimum flexible commodity rates? And should the Commission take administrative notice of Minnegasco's comments in another docket?

- Should the class allocation of Conservation Improvement Plan (CIP) costs be changed to reflect demand as well as energy?

- Should NSP recover the test year cost of certain officer incentive compensation programs?

On October 29, 1998 the Minnesota Department of Public Service (the Department) submitted its response to NSP's petition. The Department urged the Commission to affirm its Order on all three issues.

The Commission met on December 3, 1998 to consider this matter.

FINDINGS AND CONCLUSIONS

This Order will address the three issues that NSP has raised for reconsideration.

I. THE CCRC AND MINIMUM FLEXIBLE COMMODITY RATES

A. Commission's Order

In its September 30, 1998 Order, the Commission adopted the Department's analysis and found that CIP costs (whether recovered through the CCRC or the CIP Adjustment Factor) are incremental costs. Citing Minn. Stat. § 216B.163, which provides that the minimum flexible rate must recover at least the incremental cost of providing the service, the Commission concluded that NSP's minimum flexible rate must recover CIP costs. Accordingly, the Commission rejected the Company's proposals to establish minimum flexible rates that did not recover the CCRC.

B. NSP's Petition

In its petition for reconsideration, NSP disputed the Department's analysis (which the Commission had adopted in its Order) that CIP costs (including the CCRC) are incremental costs as that term is used in Minn. Stat. § 216B.163:

- NSP noted that the Department itself had argued, as recently as in a December 30, 1994 report to the legislature, that the term "incremental costs " referred only to variable operation and maintenance (O&M) costs.

- NSP acknowledged that it had included the CCRC in the minimum flexible rates that it proposed (and that the Commission approved) in the Company's 1992 rate case. However, NSP stated that it had done so in error, based on its misinterpretation of Minn. Stat. § 216B.163. NSP explained that in 1992 it had mistakenly included all class average **variable** costs (which included CIP costs) rather than all **incremental** costs (which did **not** include CIP costs) as required by the statute.

- NSP argued that requiring NSP to recover CIP costs from flexible rate customers would be unfair. The Company asserted that treating CIP costs as incremental costs and therefore requiring their recovery in minimum flexible rates would mean that CIP would account for more than 50 percent of some customers' total bill even though test year CIP costs are only 3 percent of the Company's total non-gas cost of service.

- NSP asserted that the Commission should follow the precedent set in the Minnegasco rate case (Docket No. G-008/GR-95-700) in which the Commission, according to NSP, had approved a minimum flexible rate for Minnegasco that did not include the CCRC.

- NSP also cited the Commission's Order in Docket No. G-004, 011/C-91-731 as supporting its position that CIP costs are not incremental.

C. The Department's Response

The Department countered that the Commission had correctly found that CIP costs (including those recovered through the CCRC) are incremental costs and that minimum flexible rates must recover them.

The Department rebutted NSP's assertion that the Commission had established precedent in two prior Orders that CIP costs are not incremental. With respect to the Commission's Order in Docket No. G-008/GR-95-700 (Minnegasco's rate case), the Department noted that the issue was not contested in that docket and that the Commission did not make a decision one way or another whether CIP costs are incremental. Likewise in the Great Plains Order in Docket No. G-004, 011/C-91-731, the Department noted that the character of CIP costs was not an issue.

The Department summarized that the Company had shown no reasonable basis to alter the Commission's ruling. The Department emphasized that its strong opposition to the Company's position was motivated by the fact that the Company appeared intent upon recovering from other ratepayers any CIP expenses that it chose not to recover from flexible rate customers.

D. Commission Analysis

The Commission agrees with the Department that this docket is the first time the Commission has been asked to rule specifically on the question whether CIP costs are **incremental costs** within the meaning of Minn. Stat. § 216B.163, costs which, as such, must be recovered in the minimum flexible rate. No prior Commission Order provides precedent on this question, NSP's assertions notwithstanding.

The Commission does not accept the Company's argument based on the asserted inequity of collecting the CCRC from interruptible customers. In light of the clear statutory requirement to recover incremental costs in the minimum flexible rates and the Commission's finding that CIP costs (including the CCRC) are incremental costs, the Commission's decision followed the statutory imperative and quite properly did not involve an assessment of comparative equities, as urged by NSP in this argument.

On reconsideration, however, the Commission does not continue to agree with the Department's argument that CIP costs are **incremental costs** within the meaning of that statute. In general, an **incremental cost** is a cost which rises as a direct response to a rise in output. In the context of a gas utility, the company's sales and transportation volumes may be viewed as equivalent to its output. Upon closer examination, the Commission finds that NSP's CIP costs are not simply or even most proximately a function of increases in the Company's output.

It is true that the statutorily prescribed **minimum CIP expenditure level** is 0.5 percent of NSP's gross annual revenues. As such, the **minimum CIP expenditure level** rises and falls as a direct function of NSP's gross annual revenues. And although an increase in output (sales and transportation volumes) is ordinarily associated with an increase in revenues, the level of NSP's **actual CIP spending** (as distinguished from the statutorily prescribed **minimum CIP expenditure level**) is not directly tied to NSP revenues. Instead, the amount of money the Company expends on CIP (NSP's CIP costs) is determined by and results most proximately from a directive of the Commissioner of the Department of Public Service exercising statutory authority

pursuant to Minn. Stat. § 216B.241.

Furthermore, the CIP costs required by the Commissioner of the Department of Public Service consistently and significantly exceed the statutorily prescribed **minimum CIP expenditure level**, which means they do not have a perceptible connection with (let alone vary as a result of) the level of NSP's actual output, sales, or revenue. This fact reenforces the view that the level of NSP's CIP costs is determined by the Commissioner of the Department of Public Service rather than by output.

Based on this analysis, the Commission concludes that CIP costs are not properly viewed as incremental costs and need not, therefore, be recovered in the Company's minimum flexible rates.

E. Commission Action

The Commission will modify its September 30, 1998 Order consistent with the foregoing analysis and will approve a revised flexible rates tariff that sets minimum flexible rates at levels adequate to recover only the Company's variable O&M costs. No other changes in NSP's rates for other classes of customers are authorized.

Pursuant to the modified flexible rates tariff, NSP will be allowed, in circumstances defined in the tariff, to flex down the rate for an eligible customer to the new minimum flexible rate, thereby effectively waiving recovery of CIP costs (the CCRC) in whole or in part from that customer. This amount of flexibility is appropriate since the Commission has found in this Order that CIP costs (hence the CCRC charge) are not incremental costs and, hence, there is no legal mandate that they be recovered in minimum flexible rates.

NSP will not be allowed, of course, to automatically shift recovery of any amount of CIP costs thus waived to other customers. Further, NSP has agreed that it will not petition the Commission for authority to recover any such foregone CIP recovery before the conclusion of the Commission Chair's Round Table on Energy Demand Side Management, Docket No. G, E-999/CI-98-1759. [1]

II. CLASS ALLOCATION OF CIP COSTS

A. Commission's Order

In its September 30, 1998 Order, the Commission noted that the method traditionally approved by the Commission for allocating CIP costs is an energy allocator. Consistent with that tradition, the Commission held that NSP's CIP costs should be allocated using an energy allocator, thereby charging firm and interruptible customers equally for all CIP expenses. The Commission noted that the Administrative Law Judge (ALJ) had recommended that the Commission adhere to the energy allocator method, the methodology adopted in the last NSP gas rate case. The Commission

[1] On November 19, 1998, the Commission issued an Order in Docket No. E-999/CI-98-755 convening a Chair's Roundtable on energy demand management issues. The Roundtable is to report back to the Commission by May 1, 1999.

found, as had the ALJ, that NSP departed from the energy allocator methodology without providing rational support for the change. The Commission also noted that use of the energy allocator best reflects the fact that all customers benefit from conservation expenses.

B. NSP's Petition

NSP argued that the Commission erred in rejecting the Company's proposal to allocate demand related costs to firm customers and energy related costs to all customers.

- NSP disagreed that the Commission has consistently required use of an energy allocator for gas utilities. The Company cited the Commission's Peoples Natural Gas 1992 rate case Order in which the Commission had approved an allocation of CIP costs based on class revenue, rather than the energy allocator based on class sales that the Department has recommended in the present case.

- NSP disputed the Commission's statement that NSP used an energy allocator to allocate CIP costs in its Class Cost of Service Study (CCOSS). The Company suggested that this factual misunderstanding may have led the Commission to conclude that the energy allocator was appropriate to use in allocating CIP costs.

- NSP contested the Department's assertion that the Company had not proved its case for its alternative approach. The Company asserted that its Reply Brief to the ALJ showed that every dollar value and allocation value used in its proposal was based on numbers in the record. NSP also asserted that its proposal was supported by working papers given to the Department during discovery after the Company filed rebuttal testimony, not just in Reply Briefs, as asserted by the Department.

- NSP rejected the significance of the fact that its allocation proposal here differed from what it had used in the 1992 NSP Gas rate case. The Company stated that cost allocation changes are common in general rate cases.

- NSP argued that its proposed allocation method provides a more equitable allocation of demand-related costs to interruptible customers because, since they do not pay for purchased gas demand costs, they receive no benefit from any pipeline demand or capacity costs that are avoided because of CIP expenditures.

C. The Department's Response

The Department argued that the Commission should uphold its decision to require the allocation of CIP costs using an energy allocator. The Department stated that it was conceivable that NSP could have proven the reasonableness of some kind of capacity/energy split resulting in a different CCRC for each class of customers. The Department argued, however, that the Company had failed to make that case on the record, i.e. that the record does not support NSP's alternative methodology.

D. Commission's Analysis

As a general proposition, it is preferable for those causing or benefitting from an expenditure to pay for it. In this case, it seems reasonable, as the Company argued, that an across the board allocator that collects some capacity-related CIP costs from interruptible customers may impose a rate paying burden on them that does not directly correspond to the benefit they obtain from the CIP program. This general proposition, however, is insufficient in itself to demonstrate that the Company's specifically proposed allocator (and its resulting higher CCRC for residential customers) is reasonable.

In short, the Commission finds that NSP's failure to mention its allocation proposal until its Reply Brief to the ALJ did not allow proper development and examination of the issue in the record. And subsequent arguments raised by the Company in support of its proposed allocation method also fail to carry the Company's requisite burden of proof:

- NSP argued that the Commission's decision in Peoples Natural Gas 1992 rate case shows that the Commission decisions provide no general ("traditional") starting place on this issue. However, the Peoples case (the sole gas company Order cited by NSP that deviated from the energy allocator method) simply shows that the Commission can be persuaded by an adequate record that an allocation method other than the energy allocator is reasonable.

- NSP's citing Commission approval of a demand/energy allocator in NSP's 1991 electric rate case does not demonstrate the reasonableness of what the Company asserted was a comparable demand/energy allocator in the current gas case. The record does not show, for example, that the electric and gas industries are adequately similar to warrant application of such an allocator in this case.

- The Company claimed that workpapers it provided to the Department in response to information requests contains information that provides a basis for the proposal. They do not. These papers were provided to a Department witness working on a different issue and, most fundamentally, are not part of the record of this case.

E. Commission Action

Based on this analysis, the Commission will not change its Order to require the class allocation of CIP costs reflect demand as well as energy.

III. EARNINGS PER SHARE INCENTIVE COMPENSATION PLAN

The Commission finds that on this point the Company does not raise new issues, does not point to new and relevant evidence, does not expose errors or ambiguities in the original Order, and does not otherwise persuade the Commission that it should rethink its original decision. The Commission concludes that the original decision is the one most consistent with the facts, the law, and the public interest. The original decision will be affirmed.

ORDER

1. The petition for reconsideration filed by Northern States Power Company - Gas Utility (NSP) is granted in part and rejected in part, as discussed in the text of this Order.

2. Within 15 days of this Order, NSP shall file a flexible rates tariff, revised consistent with this Order.

3. Except as specifically modified in this Order, the Commission's September 30, 1998 Order in this matter is affirmed. NSP shall have the same time periods established in the September 30, 1998 Order to take the actions required in that Order but the starting date for the time periods established in that Order shall be calculated from the date of this ORDER AFTER RECONSIDERATION.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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